

RD AN No. 3702 (4279-B)
January 28, 2002

SUBJECT: Business and Industry Guaranteed Loan Program
Purchase of Startup Cooperative Stock

TO: State Directors, Rural Development

ATTN: Business Programs Directors

PURPOSE/INTENDED OUTCOME:

The purpose of this Administrative Notice (AN) is to clarify and provide guidance in determining the procedure for handling inquiries and accepting Business and Industry (B&I) Guaranteed Loan applications for the purchase of startup cooperative stock.

COMPARISON WITH PREVIOUS AN:

This AN updates and replaces RD AN No. 3429 (4279-B) dated November 10, 1998.

IMPLEMENTATION RESPONSIBILITIES:

RD Instruction 4279-B, section 4279.113(i), authorizes the issuance of loan guarantees for the purchase of startup cooperative stock by a family-sized farm where commodities are produced by the farm to be processed by the cooperative. Since the inclusion of this item as an eligible loan purpose, several questions have been raised which need clarification. Attachment A to this AN addresses eight of those questions; however, it has been realized that additional concerns are being encountered as cooperatives are being formed and requests for B&I Guaranteed Loans are being received.

EXPIRATION DATE:
January 31, 2003

FILING INSTRUCTIONS:
Preceding RD Instruction 4279-B

State Directors are not to approve or make any commitment on any request for purchase of startup cooperative stock until the proposal has been reviewed and direction is provided by the National Office. Therefore, when a proposal is submitted or otherwise presented, the State Director is to submit a written summary of the proposal, along with any information submitted by the cooperative, to the Administrator with a copy to the Director, Business and Industry (B&I) Division.

If you have any questions, please contact the B&I Division at (202) 690-4103.

(Signed by John Rosso)

JOHN ROSSO
Acting Administrator
Rural Business-Cooperative Service

Attachment (4 Pages)

**Business and Industry Guaranteed Loan Program
Cooperative Stock Purchase – Issues**

The following are issues concerning implementation of the cooperative stock purchase authority under the B&I Guaranteed Loan Program:

1. What is the minimum equity required for each individual cooperative member receiving a B&I Guaranteed Loan for the purchase of stock?

The family-sized farmer (borrower) will already be established as an existing business entity by the time the request is made for a guarantee of the loan for purchase of cooperative stock. Consequently, the minimum equity requirement in the B&I program regulations is 10 percent and determined in accordance with Generally Accepted Accounting Principles (GAAP). This does not mean that a Certified Public Accountant needs to prepare the borrower's financial statements, but it does mean that the presentation of these statements must be formatted and based upon GAAP. A compilation or review of the financial statements will be sufficient. Such reporting will show the borrower's financial condition based on cost or current market value, whichever is less, versus the strict market value approach commonly used by many farmers and ranchers.

We understand that some members may have expressed concern that preparation of the financial statements will be prohibitively expensive. Since lenders are experienced in the preparation and evaluation of financial statements, we have decided that the Agency will accept the lender's determination that the borrower's financial statements have been prepared in accordance with GAAP.

This will be the case at the time of loan application and for the remaining life of the loan, for loan servicing purposes.

2. What collateral will be required to secure the loan?

B&I program regulations require that collateral obtained for the loan be sufficient to protect the interests of the lender and the Agency. The stock acquired with loan funds and the personal or corporate guarantees of the borrower will ordinarily be taken, but the lender will otherwise determine the sufficiency of collateral in accordance with its normal lending practices. Personal and corporate guarantees for those owning greater than 20 percent of the borrower will be required where legally permissible with some exceptions, as provided for in RD Instruction 4279-B, section 4279.149.

The borrower and lender must realize that it is the borrower's responsibility to repay the loan regardless of the success or failure of the cooperative. In the event of failure of the cooperative, the stock will likely be worth little, if anything, and collection of the personal or corporate guarantees of the borrower could be difficult. Therefore, the lender must consider the adequacy of collateral in the event of a default by the borrower.

3. At what point will the loan to the borrower be closed?

Closing a B&I Guaranteed Loan to a member of a start-up cooperative, prior to the cooperative becoming operational, is a means of capitalizing the cooperative. The cooperative's lender may require the cooperative to have the money from the stock sale under the cooperative's control and shown on its financial statement as a condition for loan approval. This would require the B&I Guaranteed Loan to the farmer, for the purchase of the stock, to be closed prior to the business becoming operational, as would be expected in a proposal of this type.

Therefore, for loans involving the purchase of cooperative stock, the Agency will put its Loan Note Guarantee in place at the time the lender closes the individual loan for the purchase of stock in the startup cooperative, even though the cooperative may not yet be operational.

4. What is the requirement for a feasibility study for this type of assistance?

In accordance with RD Instruction 4279-B, section 4279.150, a feasibility study by a qualified independent consultant may be required by the Agency for start-up businesses or existing businesses when the project will significantly affect the borrower's operation. A feasibility study is required to be completed for the cooperative, in accordance with the above-cited program regulations, and will provide for a consistent evaluation of the potential success of the business upon which the borrower's loan is based.

Where the Agency is guaranteeing the cooperative stock, a feasibility study of the individual borrowers is not necessary. The feasibility of the cooperative will determine the viability of the business and not the individual farm operators. If the cooperative is not feasible, the individual guaranteed loans for cooperative stock should not be closed.

The provisions of RD Instruction 4279-B, sections 4279.114(b) and (c), which would require a Department of Labor clearance for the cooperative, will not apply. This is based in part on the fact that no one individual loan to a farmer or rancher will create more than 50 new jobs nor will the loan exceed \$1 million, despite the collective impact of all loans.

5. Will an appraisal be required for a guaranteed loan on cooperative stock?

If it is determined that additional collateral is required, in addition to the stock (valued at its acquisition cost) and the borrower's personal or corporate guarantees, an appraisal of the additional collateral with values exceeding \$100,000 is required in accordance with Office of Management and Budget Circular A-129. See RD Instruction 4279-B, section 4279.144, regarding appraisals.

6. How will the environmental evaluation of the borrower or cooperative be accomplished?

Working capital loans (stock purchase) to the farmer or rancher are categorical exclusions under the provisions of RD Instruction 1940-G since they cannot be linked with a specific action that impacts the environment. However, there is a financial soundness link between the stock purchase loan and the environmental soundness of the start-up cooperative that issues the stock. Since the interests of the Agency are directly tied to the successful operation of the cooperative, the following is a standard requirement for all Conditional Commitments to lenders: "The cooperative will provide all required Federal, State, and local permits and other clearances involving the environmental aspects to the lender for review and approval." If the lender for the farmer or rancher chooses, it may receive the Loan Note Guarantee prior to the cooperative becoming operational, provided the lender is willing to certify to the Agency that the above requirement will be met in the future.

7. Will there be a lead State for coordinating questions and issues concerning loans for cooperatives with members (borrowers) in more than one State?

Yes. It will be easier for the cooperative to channel all of its concerns and questions through a single state as the coordinator for this effort. The lead state will be the state in which the processing facility is located. This lead state would not approve each loan but would provide for the coordination of consistent B&I program delivery and servicing processes.

The lead state will coordinate issues involving the lender and cooperative concerning policy and procedural issues and will promote a standardized methodology for loan processing and servicing.

Loans to individual farmers or ranchers will be processed and serviced in the state in which that borrower resides, regardless of where the cooperative is located.

8. What is a family-sized farm, and what is the maximum loan that will be made to any one borrower for the purchase of startup cooperative stock?

Any farmer eligible for the Farm Service Agency (FSA) Guaranteed Loan Program will be considered a family-sized farm for the purposes of this program. Eligibility criteria for the FSA Guaranteed Loan Program can be found in the 2-FLP Guaranteed Loanmaking and Servicing Handbook published by FSA. This handbook may be found on the internet at www.fsa.usda.gov. Applications received from farmers not meeting this definition will be considered on a case-by-case basis with documentation, acceptable to the Agency, as to why it should be considered a family-sized farm.